August 1, 2017

MEMORANDUM TO: Board of Directors

FROM: Doreen R. Eberley, Director
Division of Risk Management Supervision

SUBJECT: Regulatory Capital Rules: Retention of Certain Existing Transition Provisions for Banking Organizations That Are Not Subject to the Advanced Approaches Capital Rules

Summary: In 2013, the Office of the Comptroller of the Currency ("OCC"), the Board of Governors of the Federal Reserve System ("FRB"), and the Federal Deposit Insurance Corporation ("FDIC") (collectively, "the agencies") comprehensively revised and strengthened the capital rules applicable to banking organizations (the "capital rules"). The current capital rules allow banking organizations to phase-in certain risk-based capital treatment and capital deductions through the end of calendar year 2017. Staff now is seeking the approval of the FDIC Board of Directors ("FDIC Board") to publish the attached interagency proposed rule ("proposed rule") that would extend certain transition provisions in the capital rules that currently are scheduled to end on January 1, 2018. The proposed rule would be applicable only to banking organizations that are not subject to the advanced approaches framework, Subpart E of the capital rules, ("advanced approaches"). The advanced approaches framework applies to banking organizations with more than $250 billion in consolidated assets or those that have more than $10 billion in consolidated on-balance sheet foreign exposures.

Recommendation: Staff recommends that the FDIC Board approve the proposed rule and authorize its publication in the *Federal Register* with a public comment period that closes 30 days after publication.

Concur:

Charles Yi
General Counsel

Discussion:

The capital rules adopted by the agencies increased the quantity and improved the quality of regulatory capital, thereby strengthening the ability of banking organizations to absorb losses in times of market and economic stress.[1] In part, the quality of capital was improved through the implementation of more stringent requirements for regulatory capital instruments and revised deductions. Specifically, the capital rules include limits on the amount of capital that can count toward these regulatory requirements in cases where the capital is issued by a consolidated subsidiary of a banking organization and not owned by the banking organization ("minority interest").[2] The capital rules also require that mortgage servicing assets ("MSAs"), deferred tax assets arising from temporary differences that could not be realized through net operating loss carrybacks ("temporary difference DTAs"), and investments in the capital of unconsolidated financial institutions above certain thresholds be deducted from regulatory capital.[3]

The capital rules currently include transition provisions that phase-in the foregoing capital deductions over several years in order to give banking organizations sufficient time to adjust and adapt to such requirements.[4] These transition provisions end on January 1, 2018. For example, the capital deduction treatments for investments in the capital of unconsolidated financial institutions, MSAs, and temporary difference DTAs are subject to transition provisions that become fully effective on January 1, 2018.[5] In addition, starting on January 1, 2018, the risk weight for MSAs, temporary difference DTAs, and significant investments in the capital of unconsolidated financial institutions in the form of common stock that are not deducted from

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[1] The FRB and the OCC issued a joint final rule on October 11, 2013 (78 FR 62018) and the FDIC issued a substantially identical interim final rule on September 10, 2013 (78 FR 55340). In April 2014, the FDIC adopted the interim final rule as a final rule with no substantive changes. 79 FR 20754 (April 14, 2014).
[2] 12 CFR 324.21.
[3] 12 CFR 324.22(c)(4), (c)(5), and (d)(1).
[4] 12 CFR 324.300.
[5] 12 CFR 324.300(b)(4) and (d). See Tables 7 and 9 in 12 CFR 324.300.

regulatory capital will increase from 100 percent to 250 percent. Similarly, under the capital rules, the minority interest limitations for certain components of regulatory capital become fully effective on January 1, 2018.

Since the agencies' issuance of the capital rules in 2013, banking organizations and others have raised concerns regarding the regulatory burden, complexity, and costs associated with certain aspects of the capital rules particularly for community banking organizations. As explained in the Federal Financial Institutions Examination Council's March 2017 Joint Report to Congress on the Economic Growth and Regulatory Paperwork Reduction Act, the agencies are working jointly on a proposed rule to simplify certain aspects of the capital rules that are unduly complex and burdensome for smaller and less complex banking organizations ("simplification NPR"). The agencies will review the transition provisions in the proposed rule in connection with the simplification NPR.

Specifically, the proposed rule would extend the capital rules' 2017 transition provisions for the regulatory capital treatment of the following items: (i) minority interest exceeding the capital rules' minority interest limitations ("surplus minority interest"); (ii) non-significant investments in the capital of unconsolidated financial institutions; (iii) significant investments in the capital of unconsolidated financial institutions that are not in the form of common stock; (iv) MSAs; (v) temporary difference DTAs; and (vi) significant investments in the capital of unconsolidated financial institutions in the form of common stock. The transition provisions for these items are provided in Tables 7 and 9, respectively, in 12 CFR 324.300. The phase-in in calendar year 2017 of the capital treatment for these items is presented below.

Table 7 to § 324.300	
Transition period	Transitions for deductions under § 324.22(c) and (d)—Percentage of additional deductions from regulatory capital
Calendar year 2014	20
Calendar year 2015	40
Calendar year 2016	60
Calendar year 2017	80
Calendar year 2018 and thereafter	100

Table 9 to § 324.300	
Transition period	Percentage of the amount of surplus or non-qualifying minority interest that can be included in regulatory capital during the transition period
Calendar year 2014	80
Calendar year 2015	60
Calendar year 2016	40
Calendar year 2017	20
Calendar year 2018 and thereafter	0

Therefore, the proposed rule would require that non-advanced approaches banking organizations include 20 percent of any surplus minority interest in regulatory capital.

Additionally, non-advanced approaches banking organizations would continue to deduct 80 percent of the amount of investments in the capital of unconsolidated financial institutions, MSAs, and temporary difference DTAs that is not includable in regulatory capital. Further, such banking organizations would continue to apply a 100 percent risk weight to any non-deducted amounts of MSAs, temporary difference DTAs, and significant investments in the capital of unconsolidated financial institutions in the form of common stock, and continue to apply the current risk weights under the capital rules to amounts of non-significant investments in the capital of unconsolidated financial institutions and significant investments in the capital of unconsolidated financial institution not in the form of common stock that are not deducted from capital.

The proposed rule would not extend the 2017 transition provisions to advanced approaches banking organizations. Therefore, beginning on January 1, 2018, advanced approaches banking organizations would be required to apply the capital rules' fully phased-in regulatory capital treatment for minority interest, investments in the capital of unconsolidated financial institutions, MSAs, and temporary difference DTAs.

Conclusion

FDIC staff recommends that the Board approve the attached proposed rule and authorize its publication in the *Federal Register* with a public comment period that closes 30 days after publication.

Staff Contacts:

RMS

Benedetto Bosco ext. 8-6853
Michael Maloney ext. 8-6516

Legal

Michael Phillips	ext. 8-3581
Rachel Ackmann	ext. 8-6858
Catherine Wood	ext. 8-3788